

SECTION 3

FLOW-THROUGH ENTITIES (SCHEDULE K-1)

IRS Updates Schedule K-1 Reminders

The IRS has updated the Schedule K-1 reminders issued last year in [Headliner Volume 44](#). Schedules K-1 are used to report income from partnerships, S corporations, and some trusts.

The following guidance is offered for those preparing 2003 federal income tax returns:

For flow-through entities issuing Schedule K-1:

- Ensure the correct taxpayer identification numbers are used on Schedule K-1, particularly those issued to owners of entities disregarded for federal tax purposes (i.e., Single Member Limited Liability Companies.) In these situations, Schedule K-1 must be issued to the owner of the entity and reflect that owner's identification number.
- Identify "amended" information by checking the appropriate box on the Schedule K-1.

For recipients of Schedules K-1:

- Report income in the proper location on individual returns as instructed on Schedule K-1, column C.
- Avoid netting or combining income against losses or expenses. Gross income should be reported separately from other related deductions, such as unreimbursed partnership expenses or Section 179 expenses. Refer to the Schedule E instructions for information on properly accounting for deductions related to Schedule K-1 income.
- Report deductible "At Risk" or Basis Limitation losses carried forward from prior years on a separate line from current-year transactions. Do not combine (net) them with any current-year amounts. Refer to Form 8582, ***Passive Activity Loss Limitation***, for instructions on properly deducting passive activity losses. Beginning with tax year 2002, Form 8582 worksheets are required to be attached to the return.
- Identify "estimated" K-1 income. When the Schedule K-1 has not been received at the time the Form 1040 is filed, the income should be estimated. Form 8082, ***Notice of Inconsistent Treatment or Amended Return***, should be used to identify estimated K-1 income or when the investor disagrees with the amounts reported on the K-1.
- Report elections authorized by Revenue Procedure (Rev. Proc.) 2003-79 properly. This revenue procedure allows partners and shareholders impacted by a partnership or S corporation's election to change to an annual accounting period to apply a four-year ratable spread to the portion of the income attributable to the short tax year. Section 6 of the revenue procedure provides specific instructions that should be

SECTION 3

FLOW-THROUGH ENTITIES (SCHEDULE K-1)

followed to ensure the ratable portion of the income is properly reported on the partner's or shareholder's individual tax return.

Following these instructions will help you and your clients properly report K-1 information as the IRS continues its program of matching Schedule K-1 forms to individual returns.